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MAY 22 1998

BEFORE THE

# Federal Communications Commission

WASHINGTON, D.C.

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| In the Matter of<br>Proposed Revision of Maximum<br>Collection Amounts for Schools<br>and Libraries and Rural Health<br>Care Providers | )<br>)<br>)<br>)<br>) | Public Notice<br>CC Docket No. 96-45<br>DA 98-872 |

## COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS INC.

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COMMUNICATIONS HOLDINGS INC.

May 22, 1998

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**COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS INC.**

Time Warner Communications Holdings Inc. ("TWComm"), by its attorneys, hereby files comments on the Common Carrier Bureau's public notice[1] in the above-captioned proceeding.

**DISCUSSION**

In the instant public notice, the Common Carrier Bureau proposes to set the amount to be collected for the universal service schools and libraries fund for the third and fourth quarters of this year based on the projected reduction in the price cap LEC access charges to take effect on July 1, 1998. The net result of the Bureau's proposal would be a collection rate of approximately $524 million for the third quarter and the same collection rate for the fourth quarter of this year and a total schools/libraries fund of $1.67 billion for 1998. The Bureau's proposed objective is to ensure that long distance carriers

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1 See Common Carrier Bureau Seeks Comment On Proposed Revision Of 1998 Collection Amounts For Schools And Libraries And Rural Health Care Universal Service Support Mechanisms, CC Docket No. 96-45, DA 98-872 (May 13, 1998).

(which pay roughly 80% of the cost of the FCC's universal service programs) experience the same level of combined access charge/universal service payments in the third and fourth quarter that they experienced in the second quarter of this year. In other words, the IXCs' universal service contributions will increase, but those increases will be offset by access charge reductions caused by the X-Factor and productivity dividend in the FCC's price cap regime.

TWComm does not oppose setting the collection rate for the schools/libraries fund at $524 million for the third as well as the fourth quarters of 1998. Indeed, TWComm supports the FCC's effort to use universal service subsidies to ensure that all of the nation's school children have access to the Internet. In any case, the collection rate proposed in the public notice will actually result in a smaller schools/libraries fund ($1.67 billion) and thus lower carrier contribution obligations than would be the case if the Bureau sought to pay for the entire $2.02 billion in discounts requested thus far this year.[2] But TWComm does object to the reasoning offered by the Bureau in support of its proposal, and seeks here to point out the harmful implications of this reasoning if applied in the future.

First, as Commissioner Furchtgott-Roth points out in his separate statement on the notice, the long distance carriers are

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[2] See id. at 2-3.

not the only contributors to the schools/libraries fund,[3] and their customers are not the only ones that will be affected by the schools/libraries fund contribution obligations. CLECs such as TWComm that do not purchase access from incumbent LECs must contribute to universal service as well. Unlike the IXCs, CLECs will not receive any offsetting reductions in costs when the schools/libraries contribution factors go up.

Moreover, a CLEC like TWComm, which only offers service in highly competitive markets, may be required to absorb universal service payments, thus artificially reducing profit margins and discouraging efficient investment. Even where TWComm can pass its universal service payments through to customers, higher prices can artificially diminish the quantities of the services consumed. In either case, TWComm in particular and competition more generally can be significantly harmed. The Commission must not therefore consider future increases in contributions for schools and libraries accompanied by comparable access charge reductions as "costless", since they will have an impact on carriers other than IXCs, including of course CLECs such as TWComm.

Second, and more importantly, the FCC must not allow its access charge policy to be driven by the desired size of the universal service fund and the desire to avoid net cost increases for IXCs. The FCC should establish a universal service fund that

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3 See Statement of Commissioner Harold Furchtgott-Roth, CC Docket No. 96-45, at 1 (May 13, 1998).

is adequate to address the valid policy goals of universal affordability of basic telecommunications services and the support of eligible schools, libraries and rural health care providers. That inquiry must be conducted without reference to the FCC's access charge reform policy. Access charge reform policy should instead be based on efficiency principles.

TWComm is concerned, however, that future increases in the schools/libraries fund as well as the pressure to expand the federal component of the rural, insular and high cost subsidy program will cause the FCC to consider substantial future increases in carrier universal contribution obligations. While the Bureau has not here suggested that it would do so, the FCC might well be tempted to expand its subsidy programs and to prescribe access charge reductions (rather than simply allowing the existing X-Factor to lower the price cap each year) to cover such increases (at least for long distance carriers). In other words, the logic adopted in the instant notice could lead in the future to *larger* universal service programs and to access charge reductions *beyond* those that would already occur through the operation of the existing price cap rules.[4]

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[4] The Consumer Education of America and the Consumers Union reportedly filed separate letters with the FCC on May 21st asking the FCC to pay for existing universal service programs (thus avoiding any consumer charges that are being levied by IXCs to pay for the existing programs) by reducing interstate access charges to "cost." See "Consumer and Business Groups Urge Halt to Surcharges For E-Rate Program," Communications Daily, May 22, 1998 at 3. This argument is simply another extension of the flawed logic relied upon by the FCC in the Notice. Indeed, it suffers from the same problems (described below) as a proposal to pay for expanded

But prescribing further reductions in interstate access rates would undermine the FCC's sound decision to rely primarily on a market-based approach as the most efficient and practical means of lowering interstate access charges.[5] Under the market-based approach, the details of which are yet to be established by the FCC, incumbent LECs will receive increased levels of pricing flexibility as competition for interstate access develops. A market-based approach avoids the inherently inefficient ratemaking process that a prescriptive approach would require. Moreover, a market-based policy, if properly structured, will establish the preconditions for efficient CLEC investment while deterring inefficient entry.[6] Thus, a market-based approach is likely to result in dynamic efficiency gains (i.e., entry by firms with lower cost curves than the ILEC). On the other hand, prescriptive rate reductions are more likely to result primarily in less beneficial static efficiency gains (i.e., forcing prices down based on the ILECs' existing cost curves). These substantial long-term benefits of the market-based approach far

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universal service programs with further reductions in access charges.

5 See Access Charge Reform, First Report and Order, 12 FCC Rcd 15982 at ¶ 263 (1997).

6 For example, the FCC could make it clear (as it has proposed to do) that ILECs would be free to deaverage prices after a certain level of competition has developed. This would likely deter inefficient entry, since a high cost entrant would probably not he able to recover the costs of entry before the ILEC gains the flexibility to deaverage and drop its prices in areas where it faces competition.

outweigh any temporary political benefits the FCC might gain as a result of "paying for" higher universal service contribution obligations for long distance carriers through access charge prescription.

Of course, increasing the size of the federal universal service subsidy program by itself imposes costs on the industry and society, regardless of whether such increases are accompanied by access charge reductions. As the Bureau is well aware, any subsidy distorts pricing signals and causes the beneficiaries of the subsidy to buy more of a price-elastic service than they would if forced to pay cost-based prices. In some cases, the public policy benefits of subsidies justify the inefficiencies they cause. This is the case with subsidies to schools and libraries. But there are many aspects of the universal service system for which this is not the case. For example, as TWComm has explained recently in this proceeding, the FCC could reduce substantially the size of the rural, insular and high cost fund by excluding high cost, *high income* census block groups from eligibility.[7] Rather than seek to cover larger universal service funding requirements in the future through access charge prescription, the FCC should seek to prevent increases in fund size by using proposals such as TWComm's to target subsidies to those who truly need them.

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7 See Comments Regarding Universal Service Methodology, filed by TWComm in CC Docket Nos. 96-45, 97-160, DA 98-715 (April 27, 1998).

## CONCLUSION

TWComm does not object to the specific proposal contained in the instant Public Notice to set the collection rate for the schools and libraries fund at $524 million for the third and fourth quarters of this year. But for the reasons explained above, TWComm objects to the underlying reasoning adopted by the FCC in support of this proposal and to the possible effect it could have on the FCC's universal service and access charge policies.*

Respectfully submitted,

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May 22, 1998

* Electronic filing submitted via 3.5" diskette to Sheryl Todd, Accounting Policy Division.